

[REDACTED]

E:EO:T:R:2

19 APR 1982

Gentlemen:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

The information submitted discloses that you were incorporated on [REDACTED] pursuant to the laws of the State of [REDACTED]. Your articles of incorporation indicate that your purposes are; a) to enhance the quality of public decision - making in local and other governments through the use of improved analytic programs, techniques and services; b) to engage in the research and development of analytic programs, techniques and devices which will enhance local and other governmental decision - making; c) to provide educational programs and materials respecting the use of improved analytical programs, techniques and services for local and other governments; d) to serve local governments and other public governmental entities; e) to make such educational programs and analytic techniques, programs and services available to the private sector where doing so will serve the purposes of this corporation or be in the public interest.

The materials submitted indicate that your vice - president has developed a computerized fiscal impact analysis model of local governmental decisions known as the [REDACTED] model. ([REDACTED]). This computer model is designed to be used in cost/revenue analysis for a variety of municipal services. These services include programs for fire, police, airport, marina, sanitary landfill, and public transportation systems. Furthermore, you hope to add new programs which will analyze energy demands and land-use patterns. To date you have sold your model to approximately [REDACTED] governmental entities, and have tailored your service to each one according to their specific needs. Your projection for [REDACTED] is for sales to [REDACTED] entities.

The contracts you have entered into since your formal incorporation have been of two types. The initial agreements for services rendered have set compensation at cost, with indirect cost of travel and computer charges built into a hourly rate; you have also allowed a margin for further research and development. The second type of contract sold is a service contract for updating previously sold [REDACTED] models. Both of these kinds of contracts include detailed provisions on ownership of the [REDACTED] models as well as protective provisions for your underlying proprietary information.

[REDACTED]

Your articles allow you to provide your services to the private sector and you have indicated that private sector subscribers would be charged the same fees as the local governments you have contracted with.

The application and supporting materials indicate that your educational programs will be aimed at locally - elected officials and private developers. You intend to show them the impact of public development on public costs and revenues; and to provide individual analysis of private development proposals.

A brochure submitted clearly states that you offer other services in addition to the [REDACTED] model. Specifically you offer [REDACTED], a computerized listing of equipment available by cities for rental or sharing as an alternative to purchase or private vendor rental; [REDACTED], a computerized listing of recreational instructors, enabling cities to expand their program activities; and [REDACTED], a program on population, jobs and housing.

Section 501(c)(3) of the Code provides for the exemption of organizations which are organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, for the prevention of cruelty to children or animals or testing for public safety. No part of the net earnings of the organization may inure to the benefit of any individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one of the purposes specified in that section. If an organization does not meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides a definition of the term "charitable". It is used in its generally accepted legal sense and includes relief of the poor and distressed, the promotion of social welfare through charitable activities, and lessening the burdens of government.

Section 1.501(c)(3)-1(d)(3) of the Regulations provides a definition of the term "educational" as the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 1.502-1(b) of the Income Tax Regulations states that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if its operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of --

(1) A parent organizations one or more of its subsidiary organizations; or

(2) Subsidiary organizations having a common parent organization. An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

Rev. Rul. 72-369, 1972-2 C.B. 245, provides that: providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

[REDACTED]

Revenue Ruling 71-529, 1971-2 C.B. 234, provides that an organization controlled by a group of exempt organizations and providing them investment, management, and other services for a charge substantially less than cost qualified for charitable organization status under Sec. 501(c)(3).

In the case B.S.W. Group, Inc. 70 TC 352, Dec. 35, 1975 the Tax court held that a corporation that planned on offering consulting services for a fee to nonprofit, limited resource organizations engaged in various rural - related activities was not entitled to tax-exempt status because it did not operate exclusively for charitable, educational or scientific purposes. In addition, the court determined that the taxpayer had completely failed to show that its own services, or the services performed by its consultants, would not be in competition with commercial businesses such as personnel agencies, consulting referral services, real estate agents, housing rental services, banks, loan companies, trash disposal firms or environmental consulting companies.

Your organization appears to be similar to the one described in revenue ruling 72-369 because you are providing managerial and consulting type services on a regular basis for a fee. This is characterized as a trade or business ordinarily carried on for profit. Like the organization in the revenue ruling your services to date have been provided at cost and solely for exempt organizations. The fact that the municipalities are slow to pay for the services does not change the characterization of the fee structure which you assert is on a cost basis. Therefore, you can be distinguished from the organization in revenue ruling 71-529 because you do not provide your services for a charge substantially less than cost, as revenue ruling 72-369 concludes the furnishing of services at cost lacks the donative element necessary to establish this activity as charitable.

The product you sell the [REDACTED] model, is a decision information system a product commonly marketed in a commercial manner. The production of a decision information system is not a charitable, educational or scientific activity. Furthermore your product, the [REDACTED] model, is in competition with commercial businesses who produce decision information systems as well as consulting firms and environmental consulting companies. Your other services, [REDACTED], [REDACTED] and [REDACTED], will be in competition with personnel agencies,

[REDACTED]

real estate agents, housing rental services and banks. Therefore, you are like the organization in the case of B.S.W. Group, Inc. because you are not operated exclusively for charitable, educational or scientific purposes.

You have not established that your sales are to organizations having a common parent or to a parent organization, exclusively. You indicate that you plan to sell your model nation-wide to private organizations and municipalities who are not members of [REDACTED]. Although you may be considered a subsidiary of [REDACTED], section 1.502-1(b) of the Regulations provides that the subsidiary organization is not exempt from tax if its operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent organization.

Your purposes and activities are not clearly exclusively those described in section 501(c)(3) of the Code. Your primary purpose is to operate a trade or business. The information provided indicates that your primary activities are to provide management and consulting services at cost to a group of structurally unrelated exempt organizations and municipal governments. Furthermore, your articles of incorporation state that your purposes including selling your programs to the private sector as well as the public sector.

Because you have not shown that you provide your services at substantially below costs and because you do not receive outside support, we conclude that you are engaging in providing commercial services. Therefore, because you are not organized and operated exclusively for charitable purposes, or any other of the purposes specified in section 501(c)(3) of the Code, we conclude that you are not exempt from federal income tax under section 501(c)(3) of the Code.

You are required to file federal income tax returns on Form 1120 for each year that you have been in existence. Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers must be submitted in duplicate within 21 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices requirements.

-6-

[REDACTED]

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If we do not hear from you within 21 days, this ruling will become final and copies of it will be forwarded to the District Director in San Francisco. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

[REDACTED]

[REDACTED]

Chief, Rulings Section
Exempt Organizations
Technical Branch

cc: DD, San Francisco
Attn: EO Group

cc: [REDACTED]

cc: [REDACTED]

cc: [REDACTED]

[REDACTED]

Code	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Surname	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Date	4/18/82	4/12/82					